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SUBJECT: 2009 INVESTMENT CLIMATE STATEMENT - SOUTH AFRICA
(PART 1 OF 2)

REF: 08 State123907

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1. (U) Summary. In response to Ref A, this cable presents the first part of post's two-part 2009 Investment Climate Statement for South Africa. This is also Chapter 6 of the Country Commercial Guide for South Africa.

2. (U) BEGIN TEXT

Chapter 6 Investment Climate Statement FY2009

6.1 Openness to Foreign Investment

The government of South Africa is open to foreign investment, which it views as a means to drive growth, improve international competitiveness, and obtain access to foreign markets. Virtually all business sectors are open to foreign investors. No government approval is required, and there are almost no restrictions on the form or extent of foreign investment. The Department of Trade and Industry's (DTI) Trade and Investment South Africa (TISA) division provides assistance to foreign investors. The DTI concentrates on sectors in which research has indicated that the country has a comparative advantage. TISA offers information on sectors and industries, consultation on the regulatory environment, facilitation for investment missions, links to joint venture partners, information on incentive packages, assistance with work permits, and logistical support for relocation. DTI publishes the "Investor's Handbook" on its website: <http://www.thedti.gov.za/> (see "publications").

Macroeconomic management was strong over the past decade, with reduced levels of public debt, generally low inflation, and a progression from a fiscal deficit to a fiscal surplus, and a consistently positive rate of economic growth. The post-apartheid government has sought to liberalize trade and enhance international competitiveness by lowering tariffs, abolishing most import controls, undertaking some privatization, and reforming the regulatory environment. While this has resulted in several large foreign acquisitions in banking, telecommunications, tourism, and other sectors, foreign direct investment has fallen short of the government's

expectations. South African banks are well-capitalized and have little exposure to sub-prime debt or other sources of financial contagion. However, in the wake of the recent global financial turmoil, Standard & Poor's (S&P) and Fitch downgraded their outlook on South Africa's sovereign credit from "stable" to "negative" in late 2008, reflecting concerns that capital outflows could depress the rand and make it difficult for South Africa to finance its growing current account deficit.

In August 2007, the DTI launched its National Industrial Policy Framework, and accompanying Industrial Policy Action Plan, to promote a more labor-absorbing and broader-based industrialization path in four lead sectors: capital or transport equipment; automotive; chemical, plastic fabrication and pharmaceuticals; and forestry, paper and furniture. Business-process outsourcing, clothing and textiles, tourism, and biofuels were also identified for immediate attention. The Policy Framework anticipates initiatives in the form of tariff reductions, increased industrial financing, and additional incentives for investors.

The Black Economic Empowerment (BEE) strategy is a government program to increase the participation in the economy of historically disadvantaged South Africans. BEE requirements are specified in the Codes of Good Practice, which were published in the Government Gazette in February 2007. The codes set forth best practices for employment equity, skills development, enterprise development, preferential procurement, equity ownership, and small and medium-sized enterprises. They also permit multinational corporations to score equity ownership "points" through the use of mechanisms not involving the transfer of equity

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if these mechanisms are approved by DTI and the multinationals have a global corporate policy of owning 100 percent of the equity in their subsidiaries. The American Chamber of Commerce and many individual U.S. companies had pressed for the right to use such "equity equivalent" mechanisms. A firm's BEE "score" will be considered by government departments when awarding contracts, and in some cases is a requirement for tendering. While firms are not legally required to meet BEE criteria, they are less competitive for government tenders if they fail to meet the criteria. The BEE Codes of Good Practice and other pertinent BEE legislation may be found on DTI's website: <http://www.thedti.gov.za/>.

Some state-owned enterprises were privatized in the 1995-2004 period. The government has been restructuring most of the remaining state-owned enterprises rather than proceeding with plans for privatization since 2004. Transnet (transportation) is focusing on core sectors that support its freight transport and logistic business. Assets or businesses that are not part of this strategy are in the process of being sold to the private sector or are being transferred back to the government. Transnet transferred SA Express to the Department of Public Enterprises in 2008 and Transtel Telecom was sold to Neotel. Transnet is also selling off Luxrail (The Blue Train), Autopax, a passenger bus operation, and the IT service subsidiary arivia.com. The Department of Minerals and Energy (DME) contracted with US power producer AES for a 1000 MW power project, but canceled the agreement when AES was unable to fulfill its contractual obligations. Other opportunities for private investment in the power sector are likely to follow DME's announced policy to grant up to 30 percent of new energy projects to the private sector. The planned privatization of smaller parastatals, such as Safcol (forestry) and, in the case of Denel (defense), with partial buy-ins by foreign suitors of Denel subsidiaries, also afford opportunities for foreign investment.

6.2 Conversion and Transfer Policies

The South African Reserve Bank's (SARB) Exchange Control Department administers foreign exchange policy. An authorized foreign exchange dealer, normally one of the large commercial banks, must handle international commercial transactions and report every purchase of foreign exchange, irrespective of the amount, that is received by South African residents or companies. As a rule, there are only limited delays in the conversion and transfer of funds.

Non-residents may freely transfer capital into and out of South Africa, although transactions must be reported to authorities. Non-residents may purchase local securities without restriction. To facilitate repatriation of capital and profits, foreign investors should make sure that an authorized dealer endorses their share certificates as "non-resident." Foreign investors should also be sure to maintain an accurate record of investment. South African subsidiaries and branches of foreign companies are considered to be South African residents, and, are subject to exchange control by the SARB. South African companies may, as a general rule, freely remit the following to non-residents: repayment of capital investments; dividends and branch profits (provided such transfers are made out of trading profits and are financed without resorting to excessive local borrowing); interest payments (provided the rate is reasonable); and payment of royalties or similar fees for the use of know-how, patents, designs, trademarks or similar property (subject to prior approval of SARB authorities).

South African companies have been permitted to invest in other countries without restriction (although SARB approval/notification is still required) since 2004. South African individuals may freely invest in foreign firms listed on South African stock exchanges. Individual

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South African taxpayers in good standing may invest up to R750,000 in total (approximately \$107,000) in other countries. South African banks are permitted to commit up to 40 percent of their domestic capital in other countries, but only 20 percent outside Africa. In addition, mutual and other investment funds may now invest up to 25 percent of their retail assets in other countries. Pension plans and insurance funds may invest 15 percent of their retail assets in other countries.

Before accepting or repaying a foreign loan, South African residents must obtain SARB approval. The SARB must also approve the payment of royalties and license fees to non-residents when no local manufacturing is involved. When local manufacturing is involved, the DTI must approve the payment of royalties related to patents on manufacturing processes and products. Upon proof of invoice, South African companies may pay fees for foreign management and other services provided such fees are not calculated as a percentage of sales, profits, purchases, or income. SARB approval is also required for the sale of all forms of South African-owned intellectual property rights (IPR). Approval is generally granted by SARB if the transaction occurs at arms length and at fair market value. IPR owned by non-residents is not subject to any restrictions in terms of repatriation of profits, royalties, or proceeds from sales.

Further questions on exchange control may be addressed to:
South African Reserve Bank
Exchange Control Department
P.O. Box 427, Pretoria, 0001
Tel: +27 (0) 12 313-3911; Fax: +27 (0) 12 313-3197
Website: <http://www.reservebank.co.za/>

6.3 Expropriation and Compensation

The Expropriation Act of 1975 (Act) and the Expropriation Act Amendment of 1992 entitle the government to expropriate private property for reasons of public necessity or utility. The decision is an administrative one. Compensation should be the fair market value of the property. There is no record, dating back to 1924, of an expropriation or nationalization of a U.S. investment in South Africa.

Racially discriminatory property laws during apartheid resulted in highly disproportionate patterns of land ownership in South Africa. As a result, the post-apartheid government has committed to redistributing 30 percent of the country's farm land to black South Africans by 2014.

In several restitution cases, the government has initiated proceedings to expropriate white-owned farms after courts ruled that the land had been seized from blacks during apartheid and the owners subsequently refused court-approved purchase prices. In most of these cases, the government and owners have reached agreement prior to any final expropriation actions. The government has twice exercised its expropriation power. It took possession of farms in Northern Cape Province and Limpopo in March 2007 and December 2007 after negotiations with owners collapsed. The government paid the owners the fair market value for the land in both cases.

South Africa's Cabinet approved for submission to Parliament a new piece of legislation called the Expropriation Bill in March 2008. The Expropriation Bill QExpropriation Bill in March 2008. The Expropriation Bill sought resolve differences between the Act and the South African Constitution, which allows the government to expropriate land not just for reasons of public necessity but also for reasons that are "in the public interest." The bill is viewed as a government strategy to speed land redistribution; as of 2008, only 4.1 percent of total farm land had been redistributed under the government's land reform program. In August 2008, the bill was withdrawn - and ultimately scrapped - in the face of criticism from

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farmers and private sector groups that questioned its constitutionality. A retooled version of the bill is expected to resurface in 2009.

6.4 Dispute Settlement

South Africa is a member of the New York Convention of 1958 on the recognition and enforcement of foreign arbitration awards, but is not a member of the World Bank's International Center for the Settlement of Investment Disputes. South Africa recognizes the International Chamber of Commerce, which supervises the resolution of transnational disputes. South Africa applies its commercial and bankruptcy laws with consistency and has an independent, objective court system for enforcing property and contractual rights.

6.5 Performance Requirements and Incentives

DTI offers six investment incentives for manufacturing. Foreign Investment Grants may provide up to 15 percent of the value of new machinery and equipment to a maximum of R3 million (approximately \$430,000) per entity for relocation to South Africa. Industrial Development Zones (IDZ) provide duty-free import of production-related materials and zero VAT on materials sourced from South Africa, along with the right to sell into South Africa upon payment of normal import duties on finished goods. The Skills Support Program provides up to 50 percent of

training costs and 30 percent of worker salaries for a maximum of three years to encourage the development of advanced skills. The Strategic Investment Project program offers a tax allowance of up to 100 percent (a maximum allowance of R600 million (approximately \$86 million) per project) on the cost of buildings, plant and machinery for strategic investments of at least R500 million (approximately \$70 million). The Critical Infrastructure Facility supplements funds up to 30 percent of the development costs of qualifying infrastructure projects. The Small and Medium Enterprise Development Program offers a tax free grant of up to R3.05 million (approximately \$435,000) to manufacturers with assets of less than R100 million (approximately \$14 million) for a maximum of three years. The first two years of the grant is based on the investment in operating assets and the third year on the level of employment generated.

DTI established the Film and Television Production Rebate Scheme to encourage foreign and domestic investment in the local film industry. Eligible applicants may receive a rebate of 15 percent of the production expenditures for foreign productions and up to 25 percent for qualifying South African productions. Film projects must have begun after April 1, 2004 and must reach a threshold of R25 million (approximately \$3.6 million) to qualify for the rebate. Other requirements include 50 percent completion of the principal photography in South Africa and a minimum of four weeks photography time. Eligible productions include movies, tele-movies, television series, and documentaries. The maximum rebate for any project will be R10 million (approximate \$1.4 million). Details on the entire program are available at the DTI website at <http://www.dti.gov.za/>.

South Africa's various provinces have development agencies that offer incentives to encourage investors to establish or relocate industry to areas throughout South Africa. The incentives vary from province to province and may include reduced interest rates, reduced costs for leasing land and buildings, cash grants for the relocation of physical plants and employees, reduced rates for basic facilities, railage and other transport rebates, and assistance in the provision of housing.

The Industrial Development Corporation (IDC) is a self-financing, state-owned development that provides equity and loan financing to support investment in target sectors. The IDC also provides credit facilities for

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South African exporters. Several government-supported bodies provide technical assistance to industry. The Council for Scientific and Industrial Research provides multi-disciplinary research and development for industrial application.

Technifin is a government-owned corporation which finances the commercialization of new technology and products. MINTEK develops mining and mineral processing technology for company application. The Council for Geoscience undertakes geological surveys and services related to minerals exploration.

Under the National Industrial Participation Program (NIPP), foreign companies winning large government tenders exceeding \$10 million must invest at least 30 percent of the value of the imported content of the tender in South Africa.

The government initiated the Motor Industry Development Program in 1995 to restructure the South African automotive industry over a period of twelve years. The program was designed to encourage local manufacturing by means of a duty rebate scheme on imported vehicles and

component parts, to be phased out over the life of the program. In 2002, the Minister of Trade and Industry extended the program from 2007 to 2012. Import duties and duty rebates will continue to decline over this extended period. The import duty on built-up light vehicles will fall to 25 percent and the import duty on original equipment components will fall to 20 percent by 2012. In 2008, the South African cabinet approved a new Automotive Production and Development Program (APDP) to replace the MIDP. The APDP will aim to increase production in the auto sector to 1.2 million vehicles per year by 2020, with an associated deepening of components production. The APDP is structured around a mix of high tariffs and tariff credits plus other incentives. The new program updates an old program. The old program included export incentives, whereas the new program includes production incentives. The new program epitomizes the government's relatively new commitment to industrial policy as a source of job creation and growth. The government launched its National Industrial Policy Framework with an accompanying Action Plan in August 2007. As noted above in Section 6.1, the Policy Framework provides for import tariff reductions, tighter competition legislation, increased industrial financing, and an improved incentive scheme for investors in specific industrial sectors.

6.6 Right to Private Ownership and Establishment

The right to private property is protected under South African law. All foreign and domestic private entities may freely establish, acquire, and dispose of commercial interests. The securities regulation code requires that an offer to minority shareholders be made when 30 percent shareholding has been acquired in a public company that has at least ten shareholders and net equity in excess of R5 million.

State-owned enterprises dominate a number of key sectors in South Africa. Eskom supplies 94 percent of South Africa's electricity. Transnet operates the bulk of the nation's railways and ports. The South African Post Office is a legislated monopoly. Telkom is the dominant QOffice is a legislated monopoly. Telkom is the dominant fixed-line telephone operator and is 37 percent-owned by government. Neotel is a second national operator that began limited business-only operations in October 2006 and is 30 percent government owned. Neotel entered the business-to-business market in 2007 and has entered the residential market in selected areas. InfraCo, a 100 percent government-owned broadband provider, was formed using the fiber-optic networks of Eskom and Transnet in December 2006 and was approved for operations by Parliament in October 2007.

The Competition Act of 1998 and subsequent amendments

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address anticompetitive practices in both the private and public sectors. The Competition Commission has demonstrated increasing capacity to implement competition policy. There have been more frequent challenges in recent years against state-owned enterprises that compete unfairly or otherwise abuse their dominant position.

6.7 Protection of Property Rights

The South African legal system protects and facilitates the acquisition and disposition of all property rights, e.g., land, buildings, and mortgages. Deeds must be registered at the Deeds Office. Banks usually provide finance for the purchase of property by registering the mortgage as security.

Owners of patents and trademarks may license them locally, but when a patent license entails the payment of royalties to a non-resident licensor, DTI must approve the royalty

agreement. Patents are granted for twenty years - usually with no option to renew. Trademarks are valid for an initial period of ten years and thereafter renewable for ten-year periods. The holder of a patent or trademark must pay an annual fee to preserve ownership rights. All agreements relating to payment for the right to use know-how, patents, trademarks, copyrights, or other similar property are subject to approval by exchange control authorities in the SARB. A royalty of up to four percent of the factory selling price is the standard approval for consumer goods. A royalty of up to six percent will be approved for intermediate and finished capital goods.

Literary, musical, and artistic works, as well as cinematographic films and sound recordings are eligible for copyright under the Copyright Act of 1978. New designs may be registered under the Designs Act of 1967, which grants copyrights for five years. The Counterfeit Goods Act of 1997 provides additional protection to owners of trademarks, copyrights, and certain marks under the Merchandise Marks Act of 1941. The Intellectual Property Laws Amendment Act of 1997 amended the Merchandise Marks Act of 1941, the Performers' Protection Act of 1967, the Patents Act of 1978, the Copyright Act of 1978, the Trademarks Act of 1993, and the Designs Act of 1993 to bring South African intellectual property legislation fully into line with the WTO's Trade-Related Aspects of Intellectual Property Rights Agreement. Amendments to the Patents Act of 1978 were also intended to bring South Africa into line with TRIPS, to which South Africa became a party in 1999, and provides for the implementation of the Patent Cooperation Treaty.

The International Intellectual Property Alliance reported an increase in border seizures of pirated goods, as well as increased police raids in the optical disc market during 2006 and 2007. A local watchdog, the South African Federation Against Copyright Theft reported on its website (<http://www.safact.co.za/>) statistics on seizures of counterfeit DVDs as well as a growing number of successful criminal cases, including imposition of prison sentences, against pirates in 2008, demonstrating the government's commitment to IPR enforcement.